

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

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Person To Contact:

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PLR-148107-08

Date:

April 29, 2009

## LEGEND

X =

A =

B =

C =

D =

E =

Trust A =

Trust B =

Trust C =

Trust D =

Trust E =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Month =

State =

Dear :

This letter responds to a letter dated November 3, 2008, and subsequent correspondence, submitted on behalf of X by its authorized representative, requesting a ruling under § 1362(f) of the Internal Revenue Code.

#### FACTS

X was incorporated under the laws of State on Date 1. X filed an election to be an S corporation effective Date 2. On Date 3, A created revocable Trust A under the laws of State, and funded it with shares of X stock. Also on Date 3, B created revocable Trust B under the laws of State and funded it with shares of X stock.

On Date 4, A died and Trust A became irrevocable. Trust A was a qualifying shareholder under § 1361(c)(2)(A)(ii) until Date 6, two years after A's date of death. Trust A, however, continued to hold X stock until Date 7. As such, X's S corporation election terminated on Date 6 when Trust A ceased to be an eligible shareholder.

On Date 5, B died and Trust B became irrevocable. B's shares of X stock were held by Trust B until Date 7. During this period, Trust B was a qualifying shareholder under § 1361(c)(2)(A)(ii).

On Date 7, pursuant to the terms of the trust document, Trust A was divided into three different trusts, one for each of its beneficiaries, C, D, and E. Trust B was likewise divided into three different trusts, one for each of its beneficiaries, C, D, and E. As Trusts A and B had the same three beneficiaries, pursuant to the terms of the respective trust documents, the three trusts under Trust A were merged into the three trusts under Trust B, so that there would be only one trust for each beneficiary. The declaration of trust for Trust B became the trust document governing the three new trusts, Trusts C, D and E, which were for the benefit of C, D, and E, respectively. Taxpayer represents that Trusts C, D, and E did not qualify to be Qualified Subchapter S Trusts (QSSTs) and made no elections to be Electing Small Business Trusts (ESBTs).

X represents that X and the trustees and beneficiaries of Trusts A, B, C, D, and E intended that the trusts would qualify as S corporation shareholders. When the trustees, beneficiaries, and X learned of the termination of X's S corporation status, the trustees in Month amended the trust agreements to create separate trusts for each of Trusts C, D, and E to hold the S corporation stock and satisfy the requirements for QSSTs under § 1361(d)(3). The S corporation stock was transferred to these new trusts on Date 8, and the trusts made QSST elections effective Date 8.

X represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning. X further represents that at all times since Date 2, X and its shareholders have treated X as an S corporation. X and its shareholders consent to make any adjustments (consistent with the treatment of X as an S corporation) as may be required by the Secretary.

#### LAW

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any tax year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than 1 class of stock.

Section 1361(c)(2)(A)(i) provides that for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of Chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder of an S corporation.

Section 1361(c)(2)(A)(ii) provides that for purposes of § 1361(b)(1)(B), a trust which was described in § 1361(c)(2)(A)(i) immediately before the death of the deemed owner and which continues in existence after the death, is a permitted shareholder, but only for the 2-year period beginning on the day of the deemed owner's death.

Section 1361(c)(2)(A)(v) provides that for purposes of § 1361(b)(1)(B), an ESBT is a permissible shareholder.

Section 1361(d)(1) provides, in part, that in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2), the trust shall be treated as a trust described in § 1361(c)(2)(A)(i), and for purposes of § 678(a), the beneficiary of the trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1361(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply.

Section 1361(d)(3) provides that for the purposes of § 1361(d), the term “qualified subchapter S trust” means a trust (A) the terms of which require that (i) during the life of the current income beneficiary, there shall be only 1 income beneficiary of the trust, (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to the beneficiary, (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of the beneficiary's death or the termination of the trust, and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary, and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or resident of the United States. A substantially separate and independent share of a trust within the meaning of section 663(c) shall be treated as a separate trust for purposes of §§ 1361(d) and 1361(c).

Section 1.1361-1(j)(6)(ii) of the Income Tax Regulations provides that the current income beneficiary of the QSST must make the election under § 1361(d)(2) by signing and filing with the service center with which the corporation files its income tax return the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1361(e)(1)(A) provides that, for purposes of § 1361, except as provided in § 1361(e)(1)(B), the term “electing small business trust” means any trust if (i) such

trust does not have as a beneficiary any person other than (I) an individual, (II) an estate, (III) an organization described in § 170(c)(2)-(5), or (IV) an organization described in § 170(c)(1) which holds a contingent interest in such trust and is not a potential current beneficiary, (ii) no interest in such trust was acquired by purchase, and (iii) an election under § 1361(e) applies to such trust. Section 1361(e)(3) provides that an election under § 1361(e) shall be made by the trustee. Any such election shall apply to the taxable year of the trust for which made and all subsequent taxable years of such trust unless revoked with the consent of the Secretary.

Section 1.1361-1(m)(2)(i) provides, in part, that the trustee of the trust must make the ESBT election by signing and filing, with the service center where the S corporation files its income tax return, a statement that meets the requirements of § 1.1361-1(m)(2)(ii).

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that any termination shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a), or § 1361(b)(3)(B)(ii), or § 1361(c)(1)(A)(ii) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents, or (B) was terminated under paragraph (2) or (3) of § 1362(d), or § 1361(b)(3)(C), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken (A) so that the corporation for which the election was made or the termination occurred is a small business corporation or a qualified subchapter S subsidiary, as the case may be, or (B) to acquire the required shareholder consents, and (4) the corporation for which the election was made or the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to this subsection, agrees to make such adjustments (consistent with the treatment of such corporation as an S corporation or a qualified subchapter S subsidiary, as the case may be) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation or a qualified subchapter S subsidiary, as the case may be, during the period specified by the Secretary.

## CONCLUSION

Based solely on the facts submitted and the representations made, we conclude that X's election to be treated as an S corporation terminated on Date 6. We also conclude that the termination was an inadvertent termination within the meaning of § 1362(f). Accordingly, pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation from Date 6, and thereafter, unless X's S corporation election is otherwise terminated under § 1362(d).

X's shareholders, in determining their respective income tax liabilities during the termination period and thereafter, must include their pro rata share of the separately stated items of income or loss of X, as provided in § 1366, make any adjustments to basis as provided in § 1367, and take into account any distributions made by X as provided in § 1368. This ruling is contingent upon the trustees of Trusts C, D, and E filing ESBT elections effective Date 7. Each election must be filed within 60 days of the date of this letter and a copy of this letter should be attached to each election. This letter is further conditioned on Trusts C, D, and E filing any amended returns that are necessary to comply with this ruling and consistent with the treatment of these trusts as ESBTs.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling. If X or its shareholders fail to treat themselves as described above, this ruling is null and void.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion concerning whether X is otherwise qualified to be an S corporation or whether the new trusts created under Trusts C, D, and E are otherwise qualified to be QSSTs.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

Sincerely,

/s/

Leslie H. Finlow  
Senior Technician Reviewer, Branch 3  
(Passthroughs and Special Industries)

Enclosures (2)

Copy of this letter

Copy for § 6110 purposes